

## **2 THE BUDGET REVIEW: WHAT IS AT STAKE?**

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The objective of the present chapter is to provide an overview of the Commission's approach to the EU budget review. We have selected the Commission's above-mentioned "public consultation paper" as our starting point. We examine the Commission's approach in general and the twelve questions regarding general features, spending and revenue of the EU budget, as presented in the paper, in particular. Naturally, in most cases we are forced to deal with scenarios rather than provide definite answers, but these scenarios may still help us to continue reflecting on the situation. Last but not least, we try to identify some points which might be crucial if the review process is to succeed: from this point of view it is clearly of importance whether we consider it as a "golden opportunity" or perceive it as a "routine exercise"; as something new in its form, but nothing revolutionary in its content. The approach chosen by Europe's leaders in the next two years will be decisive for the long-term prospects of EU budget reform.

### **2.1 The budget review exercise**

In order to launch a public discussion on the EU budget reform, the European Commission started a "public consultation" through the publication of a Communication on 12 September 2007. The Communication serves as an introduction for the citizens to the issues at stake: it provides a brief overview of the history of the EU's budget and calls attention to a number of key questions regarding the future development of general issues, revenue and expenditure. It provides neither answers nor even alternatives – as some observers had expected – but it serves as the kick-off for a public consultation that is to be open to EU citizens until 15 April 2008.

There are different opinions about the importance of the exercise. Some consider it a "golden opportunity". The argument behind this belief is that the review is the first "official" occasion to discuss fundamental questions concerning the EU budget, without the pressure of the need to agree on a mid-term Financial Framework. Needless to say, this independence may have the positive effect of seeing reform ideas – both old and new – (again) coming into the foreground. There will certainly be a number of interesting proposals that will provide the European Commission with ammunition for the review process. The Commission's approach – as declared in the public consultation paper – will be "one of openness and no taboos: it will prepare this review with no preconceptions and encourages all interested parties to contribute to the consultation" (European Commission 2007a, p. 3).

Further on, the review by the Commission “will itself be the subject of a fundamental debate in the EU institutions and the Member States” (European Commission 2007a, p. 3). On the one hand, this may serve as proof that the exercise is taken seriously. On the other hand, however, this also points at the dangers of the method chosen for the review. If we optimistically, but not necessarily unrealistically, assume that the consultation will lead to a lot of interesting and useful ideas and the Commission uses the results as input for its position regarding the reform process, it does not necessarily mean that future debates between Member States will build on these results.

One has to be especially careful regarding the political independence of the present process. If we look at the review process *per se*, it will exist at least until the Commission formulates its proposals. However, in the long-term interest of the integration process, it is worth thinking about the credibility of the exercise. It is important to note that the results of the review process – whatever they may be – are not binding for the Member States,<sup>6</sup> so there is no principal obstacle for them to return to the old, net position-based debates in concrete discussions. In particular, we should not forget that the preparations for the next mid-term Financial Framework will probably begin relatively soon after the conclusion of the review process, most likely in 2010–2011. A return by Member States to the games played in 1997–1999 and 2003–2005 could compromise the outcome of any positive budget review in 2008–2009. At present we can only hope this will not happen. As mentioned above, there is no guarantee that the outcome of the review – which has deliberately been given independence from the preparations for the next mid-term Financial Framework – will be respected.

In any case, the budget review and its overture, the Commission’s public consultation paper, raise highly important questions. These questions (listed in Box 1) are worth serious reflection. Some of the questions are deliberately related to past experiences, while others need answers based on future objectives. The following sections are devoted to the discussion of these questions; even if finding definitive answers in the framework of the present concise paper would be too ambitious, any contribution to the reflection on them may help save these twelve questions from becoming just another dozen.

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<sup>6</sup> This point was confirmed in most interviews of the author with European Commission officials and Members of the European Parliament in July 2007.

## Box 1 The questions posed by the European Commission

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### General issues

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1. Has the EU budget proved sufficiently responsive to changing needs?
2. How should the right balance be found between the need for stability and the need for flexibility within multi-annual financial frameworks?

### Expenditure

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3. Do the new policy challenges set out here (i.e. in the European Commission's public consultation paper, see below) effectively summarise the key issues facing Europe in the coming decades?
4. What criteria should be used to ensure that the principle of European value added is applied effectively?
5. How should policy objectives be properly reflected in spending priorities? What changes are needed?
6. Over what time horizon should reorientations be made?
7. How could the effectiveness and efficiency of budget delivery be improved?
8. Could the transparency and accountability of the budget be further enhanced?
9. Could enhanced flexibility help to maximise the return on EU spending and political responsiveness of the EU budget?

### Revenue

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10. What principles should underpin the revenue side of the budget and how should these be translated in the own resources system?
  11. Is there any justification for maintaining correction or compensatory mechanisms?
  12. What should be the relationship between citizens, policy priorities, and the financing of the EU budget?
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Source: European Commission (2007)

## 2.2 General issues

Regarding the EU budget in general, one can have at least two different points of view. The first view is very practical and closely related to the existing rules of the budgetary framework; the second one seeks optimal solutions. Both are worth brief consideration.

Regarding the first point of view, one can argue that the budget works just fine. Since 1988, despite tensions between Member States during Financial Framework negotiations, agreements have always been reached on time (although not without difficulty). The budget is intended (at least in principle) to help the realisation of the EU's objectives, and, as Member States are aware of this need, the result of their negotiations will supposedly reflect this. The generally successful financial management of some major integration "projects", such as the Cohesion Policy and Eastern enlargement, can be regarded as proof. Even some statements in earlier reports by the European

Commission (see European Commission 1998 and 2004a)<sup>7</sup> support this view: even though there are facts that do not necessarily point in the same direction, the Commission emphasised in these reports that the *functioning* of the budget has never been in any danger, despite all the tensions, and that the available resources have been sufficient to cover the needs (although the latter is guaranteed by definition through the flexible GNI resource).

While the above statements are true in themselves, it is worth looking at the budget from the second point of view as well. Did the budget really cover the *real needs*? Are the above-mentioned examples – the financing of the Cohesion Policy and Eastern enlargement – also examples of optimal solutions? The answer is arguably no: they were to a much greater extent a result of tough negotiations, allowing Member States to reach agreements based on the lowest common denominator. This common denominator approach has until now been sufficient to deal with the given “projects” in a more or less satisfactory way but the problem is that they are generally not pursued with a view to reaching optimality with regard to the *content* of the “projects”. In some cases (the most striking example being the Lisbon Agenda) they have even been based on the willingness of Member States to contribute to them.

There is also a more general problem regarding the ability of the EU budget to cope with changing needs. The EU budget is by definition supposed to be a budget designed to cover certain common needs. It follows that these should first be identified<sup>8</sup> and that their financing should be subsequently assured. Although it may be less obvious than in the two areas mentioned above, the problem concerns the whole budget. Due to the pressure from an increasing number of Member States, the size of the budget is limited. Realistically its increase is more or less a function of the EU’s economic growth. Moreover, expenditure on items judged as important, such as policies supporting the fulfilment of the Lisbon objectives, is limited. Since we cannot expect a substantial increase in the size of the budget, at least in the foreseeable future according to the present “EU budget climate”, this situation is not likely to change.<sup>9</sup>

Regarding the other question, i.e. the role of the multiannual frameworks, the experiences have been very positive in the last two decades: after the 1980s budget debacles, the establishment of the frameworks introduced much more predictability into the process and they also reduced tensions

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<sup>7</sup> While these reports discuss the own resources system, part of their statements concern the budget in general as well.

<sup>8</sup> See section 3 of the present paper for some new ideas regarding EU spending.

<sup>9</sup> Of course, except for important restructuring on the expenditure side – see section 3.

considerably – at least in terms of the frequency of heated debates. This is a very important achievement that should be preserved. On the other hand, mechanisms should be created to ensure more flexibility, if the EU is to be able to quickly respond to a changing environment. Such flexibility can be achieved in different ways. One possibility is to introduce a mid-term review of the mid-term Financial Framework. Based on the experiences of the previous period and on new challenges that have revealed themselves up until the review, necessary adjustments could then be agreed upon. Another possibility is to either introduce a separate heading for actions that have become necessary *after* an agreement on a new Financial Framework has been reached, or by using the margin between the actual amounts spent and the ceiling of the EU budget. The modification of the length of the mid-term Financial Frameworks, e.g. from seven to five years, might in itself contribute to more flexibility.<sup>10</sup>

## 2.3 Spending

Regarding spending, the Commission's public consultation paper discussed several new policy challenges which one way or another should be addressed by the EU's policies and thus possibly through its budget. An edited list of these challenges is presented in Box 2.

Arguably, at first glance all of the enumerated items seem very important. However, there are several aspects to consider before we can reach any firm conclusions. The effects of globalisation, the problem of long-term energy security or of climate change are crucial for all Member States, even though they are not necessarily equally challenging for all of them. With regard to these and related issues, partially figuring in the above list and where the effects hit all Member States, EU action and thus EU budget (co)financing seems a logic step to take. In other issues, where there are more substantial differences as to how Member States are affected (e.g. migratory pressures), and where their traditions differ (e.g. structure and balance of society), there may be less of a role for the EU budget to play. In any case, the EU should not create objectives resembling the original Lisbon Agenda. While visions are necessary, the opportunity to realise them rests on the presence of concrete and realistic objectives that are accompanied by adequate tools.

Bearing all this in mind, the list provided by the Commission's public consultation paper arguably covers the most important fields where the EU

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<sup>10</sup> In addition, it could also be synchronised with the terms of the European Commission and of the European Parliament; on this, see more in Begg (2007).

## Box 2 New policy challenges set out in the Commission's public consultation paper

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- Growing diversity and change; an ever complex global environment
  - Scientific and technological progress: knowledge, mobility, competitiveness, innovation
  - Transformation to a knowledge and service economy
  - Structure and balance of society: economic efficiency and inter-generational equity
  - Solidarity: Europe's commitment to social justice; economic and social cohesion
  - The impact of climate change on Europe's environment and society
  - The pressures of climate change on EU policies on Europe's agriculture, countryside, rural society and maritime areas
  - Secure, sustainable and competitive energy
  - Migratory pressures from outside
  - Security and safety of citizens
  - Need for Europe's effective presence worldwide
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Source: European Commission (2007), own editing

could, and indeed should, respond to common challenges. In the final analysis it is the Member States' decision whether and in which fields they want to press ahead together and where national policies should prevail, even if in some cases (e.g. the first three issues mentioned above) the European approach seems to be the only logical choice. In any case, if a decision is reached to act in concert, adequate finances should be assured where needed, and in some cases the best way to do this would be to include them in the expenditure headings of the EU budget.<sup>11</sup>

The reorientations should be made as soon as possible. However, we should not lose sight of the political reality. Accordingly, while an agreement on future priorities still seems an ambitious aim, the budget review 2008/2009 may really be a golden opportunity and the changes could be applied from the beginning of the next Financial Framework. In the case of highly contested issues, changes could be introduced gradually or phased-in at a later stage according to an agreed timetable.

Regarding European value added, a phrase often invoked in Community parlance, there exists neither an agreed definition, nor a clear measure.

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<sup>11</sup> It is necessary to emphasise that the inclusion of any task in the EU budget does not mean (in itself) extra costs for the Member States; it is a redistribution of resources in order to fulfil tasks which can hopefully be addressed with greater efficiency at the EU than at the Member State level. Regarding the instruments used to decide at which level to intervene, the subsidiarity test developed by Pelkmans is worth serious consideration; see Pelkmans (2006) and Ederveen and Pelkmans (2006).

However, if programmes necessitating cooperation between Member States are given priority, the chances of obtaining more European value added (whatever this may be exactly) may increase. It is of crucial importance that national development objectives are in line with each other and correspond better to the requirements of the international environment.

The budget should concentrate on issues seen as important today and tomorrow, not on the *status quo* which has been the result of the previous decades. It does not necessarily mean that the Common Agricultural Policy, for instance, should be abolished: its objectives and, accordingly, its tools and its weight in the EU budget (and potentially also in the national budgets) should be reformed in light of present and future needs. This process has already begun. Clearly defined EU tasks – together with the concentration of EU financing – would result in a more transparent EU budget, and would also be closer to the average European citizen. This would also help enhance accountability: the simpler the rules are, the easier they are to monitor, control and evaluate.<sup>12</sup>

Effectiveness and efficiency of EU spending could also be enhanced by linking spending to the fulfilment – directly or indirectly – of related EU criteria. An example of this is the fulfilment of the Maastricht criteria or, in the countries which are already members of the euro zone, the compliance with the Stability and Growth Pact. Similar dispositions might reduce the space for suboptimal Member State behaviour that is detrimental to EU objectives.

## **2.4 Revenues**

The position on revenue criteria in the Commission's public consultation paper is the following (European Commission 2007a, pp. 11-12):

The sources and mechanisms of funding the EU budget should ensure an adequate funding of EU policies. They should be judged against commonly agreed principles such as economic efficiency, equity, stability, visibility and simplicity, administrative cost-effectiveness, financial autonomy and sufficiency. None of the funding sources of the EU budget satisfies all of these principles to the same extent, and it is difficult to conceive an "ideal" funding system. However, the resources structure should seek to comply with the most important funding principles to the greatest possible extent, while minimising negative effects from the perspective of other relevant principles. To achieve that objective, choices have to be made on the principles and their relative importance.

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<sup>12</sup> Simplicity means first of all fewer exceptions, special conditions, etc., and it is not enough in itself – a coherent and comprehensible set of general rules could be regarded as optimal from this point of view. This should not exclude flexibility, also according to general rules.

These criteria are not new at all: in 1998, the Commission's report on the financing of the European Union basically established the same criteria for the own resources system; the next Commission report, published in 2004, repeated – and in some aspects specified – these criteria.

The fundamental question is the one on the choices of principles and their relative importance. In order to give a “perfect” answer to this question, we would have to be able to predict the future of the integration process. The choices would differ substantially if, on the one hand, the integration process develops into a real economic and, later on, a closer political union and, on the other hand, the internal development of the integration process remains more or less at the same level as today. In particular, questions about the relationship between citizens, policy priorities, and the financing of the EU budget depend to a great extent on the prospects of the whole integration process.<sup>13</sup>

While we are not sure about the finality, we may have some practical considerations: as there are policies to be financed, sufficiency of resources is of paramount importance. It should not be endangered, so the stability of the resources (guaranteed one way or another) is also crucial. Equity considerations are also important, especially at a moment when the European Commission and the Member States try to rethink the whole system and reach an agreement on reform. Further considerations are also important but there is little danger of treating them more flexibly.

Once we have a modern, forward-looking set of spending priorities agreed upon by the Member States *and* a system of own resources reflecting a consensus or even a compromise between Member States, exceptions, corrections and specific compensations have no place in the system. The only device conceivable that would conform to a well-functioning system would be a system of safeguard measures, taking into account not specific cases but potential situations judged to be worth avoiding.<sup>14</sup> Of course, it would be the ideal case, but we should bear this logic in mind when we look for real steps forward from the current situation.

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<sup>13</sup> Among other things, the introduction of an EU tax is very much dependent on these considerations.

<sup>14</sup> It is important to emphasise two things here. First, it is clearly about a system, and not about exceptions tailored to some country-specific needs. Second, such a system should be constructed in a way that it would be able to fulfil its function if necessary. The failure of the “dynamic brakes” mechanism in the 1970s demonstrates the importance of this second aspect.